REPORT OF EXAMINATION

OF THE

THE DENTISTS INSURANCE COMPANY

AS OF

DECEMBER 31, 2009

Participating State
and Zone:

California

Filed June 3, 2011

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San Francisco, California
May 12, 2011

Honorable Joseph Torti, III
Chairman of the NAIC Financial
Condition Subcommittee
Superintendent of Business Regulation
Division of Insurance
Cranston, Rhode Island

Honorable Linda S. Hall
Secretary, Zone IV-Western
Director of Insurance
Alaska Division of Insurance
Anchorage, Alaska

Honorable Dave Jones
Insurance Commissioner
California Department of Insurance
Sacramento, California

Dear Chairman, Secretary, and Commissioner:

Pursuant to your instructions, an examination was made of

THE DENTISTS INSURANCE COMPANY

(hereinafter also referred to as the Company) at its home office located at 1201 K Street, Sacramento, California 95814.

## SCOPE OF EXAMINATION

The previous examination of the Company was made as of December 31, 2005. This examination covers the period from January 1, 2006 through December 31, 2009. The examination was conducted in accordance with the National Association of Insurance Commissioners' Financial Condition Examiners' Handbook. The Handbook requires the planning and performance of the examination to evaluate the Company's financial condition, to identify prospective risks, and to obtain information about the Company, including corporate governance, identification and assessment of inherent risks, and the evaluation of the system controls and procedures used to mitigate those risks. The examination also included an assessment of the principles used and the significant estimates made by management, as well as an evaluation of the overall financial statement presentation, and management's compliance with Statutory Accounting Principles and Annual Statement instructions. All accounts and activities of the Company were considered in accordance with the risk-focused examination process.

In addition to those items specifically commented upon in this report, other phases of the Company's operations were reviewed including the following areas that require no further comment: corporate records; fidelity bonds and other insurance; pensions, stock ownership and insurance plans; growth of company; loss experience; statutory deposits; and sales and advertising.

## SUBSEQUENT EVENTS

The Company owns a 40 percent interest in the CDA Rotunda Partners, LLP (RP). In January 2010, RP refinanced the outstanding balance of the long-term note secured by the 1201 K Street, Sacramento, California building. The outstanding principal was $33,961,055 and was replaced with a note of $35,300,000 due in 10 years and amortized over 30 years.

In 2010, the Company began the implementation process of an insurance policy management system. In the same year, management decided to discontinue the policy system implementation. During the fourth quarter of 2010, the Company wrote off $1,433,263, which represents the development costs incurred during 2010. The total amount is shown as an expense on the 2010 Annual Statement.

On January 26, 2011, the Company received approval from the California Department of Insurance to amend the Company's Certificate of Authority to allow it to write workers' compensation insurance. The Company began writing workers' compensation insurance in California on April 1, 2011. Total workers' compensation premiums collected through the end of April 2011 were $6.7 million.

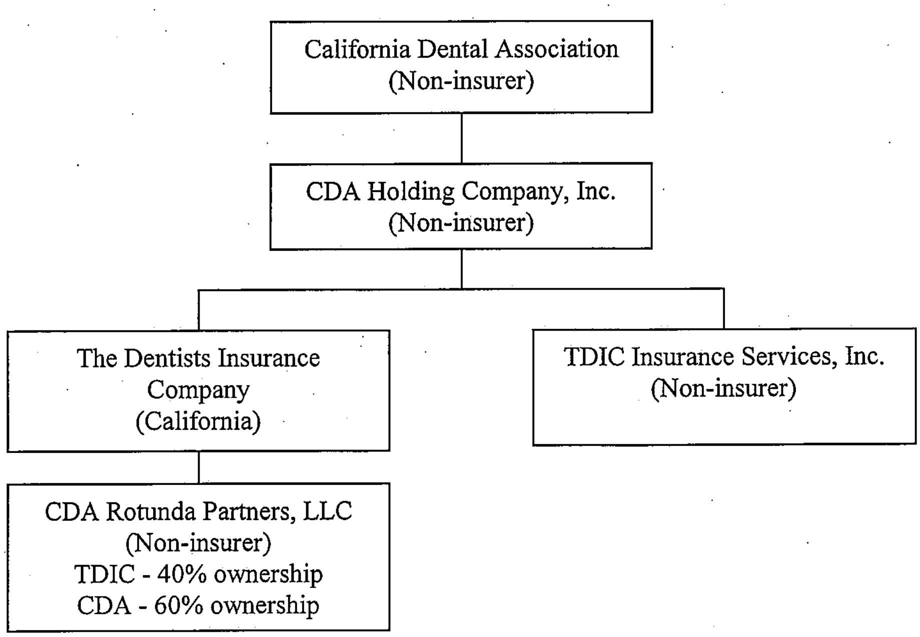
## COMPANY HISTORY

The Company paid the following ordinary cash dividends to its parent, CDA Holding Company, Inc., during the examination period:

| Date Paid | Amount |
|---|---|
| 2/01/2006 | $1,557,183 |
| 1/23/2007 | $1,694,917 |
| 1/15/2008 | $1,788,239 |
| 1/19/2009 | $1,878,088 |
| 1/15/2010 | $1,990,177 |
| Total | $8,908,604 |

## MANAGEMENT AND CONTROL

The Company is a member of an insurance holding company system, of which the ultimate controlling entity is the California Dental Association (CDA). The following chart depicts the interrelationship of the companies within the holding company system as of December 31, 2009 (all ownership is 100% unless otherwise indicated):



Management of the Company is vested in a seventeen-member board of directors elected annually. The directors and principal officers at December 31, 2009 were as follows:

Directors

| Name and Residence | Principal Business Affiliation |
|---|---|
| Phillip J. Abeldt, DDS<br>Lodi, California | Dentist |
| Matthew J. Campbell, DDS [(a)]<br>Sacramento, California | Dentist |
| Steven C. Crowson, DMD<br>Butte, California | Dentist |
| Robert C. Daby, DDS<br>Sacramento, California | Dentist |
| Daniel G. Davidson, DMD [(b)]<br>Kentfield, California | Dentist |
| Dennis C. De Tomasi, DDS<br>Sutter, California | Dentist |
| Peter A. DuBois<br>San Francisco, California | Executive Director<br>California Dental Association |
| Naomi L. Ellison, DDS [(a)]<br>Santa Monica, California | Dentist |
| James P. Green, DDS [(b)]<br>Valley Springs, California | Dentist |
| Bettina M. Hooper [(b)]<br>Carmichael, California | Insurance |
| William L. Marble, DDS<br>Woodland, California | Dentist |
| Walter W. Noce, Jr.<br>Pasadena, California | Healthcare |

Directors (continued)

| Name & Residence | Principal Business Affiliation |
|---|---|
| James S. Richardson<br>Elk Grove, California | President and CEO<br>The Dentists Insurance Company |
| Richard E. Sinaiko<br>Pacific Palisades, California | Healthcare |
| Andrew P. Soderstrom, DDS [a]<br>Modesto, California | Dentist |
| Ann L. Steiner, DMD<br>Yucaipa, California | Dentist |
| Walter G. Weber, DDS<br>Monte Sereno, California | Dentist |

*[a] The terms for Matthew J. Campbell, Naomi L. Ellison and Andrew P. Soderstrom expired on January 13, 2010. Cleland G. Ehrler and Lindsey A. Robinson were elected to the Board on January 13, 2010.*

*[b] The terms for Daniel G. Davidson, James P. Green, and Bettina M. Hooper expired on January 6, 2011. Steven J. Kend, Natasha A. Lee, Carol J. McCutcheon, Sanjay Patel, James D. Stephens, and Kevin K. Stockton were elected to the Board on January 6, 2011.*

Principal Officers

| Name | Title |
|---|---|
| James S. Richardson | President and Chief Executive Officer |
| Robert F. Spinelli | Chief Financial Officer |
| Daniel G. Davidson* | Secretary and Treasurer |
| Alison P. Sandman | Assistant Secretary and General Counsel |
| Kevin C. Roach | Assistant Treasurer and Vice President of Finance |

**Daniel G. Davidson was replaced by Cleland G. Ehrler as Secretary and Treasurer in 2010.*

Intercompany Agreements

On January 1, 1990, the Company entered into a sublease agreement with the California Dental Association (CDA). The sublease agreement covers the Company's main office at 1201 K Street, Sacramento, California. Under the terms of the agreement, the Company pays the CDA a base rent plus a pro rata share of the operating costs for the premises. The base rent payment is $700,886.40 per year plus an operating cost of $6.50 per square foot. Rent expense paid to the CDA under the terms of the sublease agreement was $872,616, $879,857, $888,090, and $891,467 for 2006, 2007, 2008, and 2009, respectively. The sublease agreement was approved by the California Department of Insurance (CDI) on December 22, 2004.

Effective January 17, 2010, the Company entered into a First Restated Sublease agreement with the CDA. The First Restated Sublease agreement is an extension of the above sublease agreement between the Company and the CDA which expired on January 16, 2010. Under the terms of the restated sublease agreement, the Company pays the CDA a base rent of $2.90 per square foot per month of the Company's rentable square footage plus a pro rata share of the operating costs for the premises. The restated sublease agreement was approved by the CDI on September 22, 2010.

On January 25, 2000, the Company entered into a tax allocation agreement with the CDA Holding Company, Inc. (CDAHCI) and TDICIS. Under the terms of the agreement, CDAHCI will file a consolidated federal tax return for the group. The tax liability is allocated to each company on a separate federal income tax return basis. Additionally, each company is allocated any tax benefit due to its income tax losses or any other credits when utilized by the consolidated tax group. On January 18, 2000, the CDI authorized the Company to proceed with the tax allocation agreement.

Effective January 1, 2007, the Company entered into an amended and restated service agreement with its ultimate parent, the CDA. This agreement amends the previously approved service agreement between the two parties. Under the terms of the service agreement, the CDA will provide the Company with the following services: sponsorship; advertising; partnerships and scientific session exhibit opportunities; government relations services; legal; human resources; financial services; investment; information technology; marketing; mailroom; print shop; website; and advertising. Compensation for the services above is at actual cost and payable monthly. The Company paid $2,833,275, $3,692,573, $3,675,114, and $3,524,534 to the CDA for the above services during 2006, 2007, 2008, and 2009, respectively. The amended and restated service agreement was approved by the CDI on August 18, 2009.

Effective April 1, 2009, the Company entered into a revised service agreement with its affiliate TDIC Insurance Solutions (TDICIS). This agreement amends the previously approved service agreement between the two parties. Under the terms of this agreement, TDICIS provides the Company with the following services: policyholder services; sales; sales and distribution management; new application and policy changes; and service center report. The Company provides TDICIS with the services of its President and Chief Executive Officer and executive support services. Compensation for the services above is at actual cost and payable monthly. The Company paid $3,705,891, $2,526,107, $3,137,741, and $3,357,109 to TDICIS for the above services in 2006, 2007, 2008, and 2009, respectively. The revised service agreement was approved by the CDI on August 18, 2009. Effective March 15, 2011, the Company entered into an amended and restated service agreement with TDICIS which amends the above service agreement to include all lines of insurance underwritten by the Company. All other terms remain the same. The amended and restated service agreement was approved by the CDI on February 23, 2011.

Commitments and Contingent Liabilities

The Company's subsidiary, CDA Rotunda Partners, LLP (RP), has a ground lease with Health Property Associates (HPA), an unrelated third party. Under the terms of the HPA ground lease, the Company has guaranteed RP's performance of obligations, covenants and agreements, including the future minimum lease payments to be paid under the lease. The minimum annual payments under the ground lease are $683,004. RP has the option to purchase the land under the lease on December 1, 2039. The other party to the RP venture, the CDA, is not required to guarantee performance of RP's obligations under the HPA ground lease.

Intercompany Loan

On March 17, 2009, the Company made an unsecured loan to RP for a lobby remodel of the 1201 K Street building. The promissory note is for $1.6 million with a fixed interest rate of 5.82 percent per annum and will be paid over 10 years. The outstanding balance at December 31, 2009 was $1,509,528. The amount of the promissory note is below the threshold described under California Insurance Code Section 1215.5(b)(1)(A) that would require the Company to obtain prior approval from the CDI.

## TERRITORY AND PLAN OF OPERATION

The Company's principal line of business is medical malpractice insurance for dental professionals. Medical malpractice policies are issued on a claims-made basis. The Company also offers an extended reporting endorsement to its medical malpractice policyholders which allows coverage to continue after the policyholder dies, becomes disabled or retires or whose insurance is no longer written with the Company. The extended reporting endorsements essentially change the policy to respond to future reported claims on an occurrence basis. The Company also writes commercial multiple-peril insurance covering office building and business personal property and premises liability. In 2008, identity recovery and equipment breakdown coverages were added as options to the Company's policies. Data compromise was also added as an option in 2009. The identity recovery endorsement is offered on a family and individual basis on the professional liability coverage. The equipment breakdown and data compromise endorsements are offered under the property coverage. The identity recovery, equipment breakdown, and data compromise coverages are reinsured by The Hartford Steam Boiler Inspection and Insurance Company under a 100 percent quota share reinsurance contract (refer to the "REINSURANCE" section for more information).

As of December 31, 2009, the Company was licensed to write property and casualty insurance in the following states:

| | | | |
|---|---|---|---|
| Alaska | Indiana | Montana | South Carolina |
| Arizona | Iowa | Nebraska | South Dakota |
| Arkansas | Kansas | Nevada | Tennessee |
| California | Louisiana | New Jersey | Texas |
| Colorado | Maryland | New Mexico | Utah |
| Connecticut | Massachusetts | North Dakota | Vermont |
| Georgia | Michigan | Ohio | Washington |
| Hawaii | Minnesota | Oklahoma | West Virginia |
| Idaho | Mississippi | Oregon | Wisconsin |
| Illinois | Missouri | Pennsylvania | Wyoming |

During 2009, the Company wrote direct premiums of $45 million with 86.4 percent written in California, 3 percent in Minnesota, 2.8 percent in Hawaii, 2.6 percent in Pennsylvania, 2.1 percent in Illinois, and the remaining in Alaska, Arizona, Georgia, Nevada, New Mexico, New Jersey, and North Dakota. The Company discontinued writing new business in Georgia and New Mexico effective January 1, 2009, but continues to maintain its Certificate of Authority in both states.

Business is acquired through both direct underwriting and independent agents. Policies are written directly by the Company's underwriters in the states of Arizona and North Dakota. In California, Alaska, Georgia, Hawaii, Illinois, Minnesota, Nevada, New Mexico, and Pennsylvania business is produced by the affiliated broker TDIC Insurance Solutions, Inc. and by independent agents.

The Company is the endorsed dental medical malpractice insurance carrier for the California Dental Association, Alaska Dental Society, Inc., Hawaii Dental Association, Illinois State Dental Society, Nevada Dental Association, New Jersey Dental Association, and Pennsylvania Dental Association.

## REINSURANCE

### Assumed

The Company does not assume reinsurance.

### Ceded

The following is a summary of the Company's reinsurance agreements as of December 31, 2009:

| Treaty Type | Reinsurer(s) | Company's Retention | Reinsurer's Limit |
|---|---|---|---|
| Property Excess of Loss | Lloyd's Underwriters Syndicate No. 2001 AML (Unauthorized)<br><br>Allied World Reinsurance Company (Authorized)<br><br>Hannover Ruckversicherung AG (Unauthorized)<br><br>Montpelier Reinsurance Ltd. (Unauthorized) | 1st Layer<br>$500,000 each and every loss, each and every risk<br><br>2nd Layer<br>$1 million, each and every loss, each and every risk<br><br>3rd Layer<br>$2 million, each and every loss, each and every risk | 1st Layer<br>$500,000 excess of $500,000, each and every loss, each and every risk<br><br>2nd Layer<br>$1 million excess of $1 million, each and every loss, each and every risk<br><br>3rd Layer<br>$2 million excess of $2 million, each and every loss, each and every risk |
| Property Catastrophe Excess of Loss | Lloyd's Underwriters Syndicate No. 2001 AML (Unauthorized)<br><br>Allied World Reinsurance Company (Authorized)<br><br>Hannover Ruckversicherung AG (Unauthorized)<br><br>Montpelier Reinsurance Ltd. (Unauthorized) | 1st Layer<br>$1.5 million, each and every loss occurrence<br><br>2nd Layer<br>$5 million, each and every loss occurrence | 1st Layer<br>$3.5 million excess of $1.5 million, each and every loss occurrence<br><br>2nd Layer<br>$10 million excess of $5 million, each and every loss occurrence |
| Liability Excess of Loss | Lloyd's Underwriters Syndicate No. 2001 AML (Unauthorized)<br><br>Hannover Ruckversicherung AG (Unauthorized) | 1st Layer<br>$750,000 each and every loss and $750,000 in respect to each and every policy | 1st Layer<br>$750,000 excess of $750,000 per occurrence, subject to an aggregate limit of $3.75 million in respect of each and every policy and an annual |

| Treaty Type | Reinsurer(s) | Company's Retention | Reinsurer's Limit |
|---|---|---|---|
| | | | aggregate limit of $7.5 million |
| | Montpelier Reinsurance Ltd. (Unauthorized)<br><br>Odyssey America Reinsurance Corporation (Authorized)<br><br>PARIS RE (Unauthorized)<br><br>QBE Reinsurance Corporation (Authorized) | 2nd Layer<br>$1.5 million each and every loss and $4.5 million in respect to each and every policy | 2nd Layer<br>$5 million excess of $1.5 million per occurrence, subject to an aggregate limit of $5.5 million in respect of each and every policy and an annual aggregate limit of $11 million |
| Equipment Breakdown 100% Quota Share | The Hartford Steam Boiler Inspection and Insurance Company (Authorized) | None | 100% quota share, subject to a limit of $10 million any one accident, any one policy |
| Data Compromise 100% Quota Share | The Hartford Steam Boiler Inspection and Insurance Company (Authorized) | None | 100% quota share, subject to a $250,000 annual aggregate limit per policy and an annual aggregate limit of $1.2 million for each calendar year |
| Identity Recovery 100% Quota Share | The Hartford Steam Boiler Inspection and Insurance Company (Authorized) | None | 100% quota share, subject to a $15,000 annual aggregate limit as respects any identify theft recovery insured |

The insolvency clause in all three reinsurance agreements with The Hartford Steam Boiler Inspection and Insurance Company (HSB) are not in compliance with California Insurance Code Section (CICS) 922.2(a) and California Code of Regulations (CCR), Title 10, Chapter 5, Subchapter 3, Article 3, Section 2303.13(d). The language in the insolvency clauses in the above agreements differs materially from CICS 922.2(a) and includes references to New York laws which do not apply since the laws of California are the governing laws. References to New York laws are also in the insolvency clauses in the Property Excess of Loss, Property Catastrophe, and Liability Excess of Loss reinsurance agreements. It is recommended that the reinsurance agreements with HSB be amended to comply with CICS 922.2(a) and CCR, Title 10, Chapter 5, Subchapter 3, Article 3, Section 2303.13(d). It is also recommended that all references to non-California laws be removed from the reinsurance agreements.

The Data Compromise and Identity Recovery quota share reinsurance agreements with HSB do not comply with CCR Title 10, Chapter 5, Subchapter 3, Article 3, Section 2303.14(b) because the agreements include an early termination provision that permits the reinsurer to terminate the agreement in the event the Company becomes insolvent or suffers any impairment of capital or becomes the subject of any liquidation, rehabilitation, receivership, supervision, conservation, or bankruptcy action, etc. CCR Section 2303.14(b)(A) does not permit the reinsurer to terminate the agreement upon the entry of an order of rehabilitation, conservation or liquidation against the ceding insurer. In addition, the reinsurance agreement allows the reinsurer to terminate the agreement within 45 days upon the happening of any of the above events in violation of CCR Section 2303.14(b)(B) which requires written notice to be given to the ceding insurer of not less than 60 days prior to the effective date of termination. Furthermore, CCR Section 2030.14(b)(C) also requires signature upon delivery of the notice. It is recommended that the above reinsurance agreement be amended to comply with CCR, Title 10, Chapter 5, Subchapter 3, Article 3, Section 2303.14(b), paragraphs (A) thru (C).

The Company is currently working with its reinsurers and reinsurance intermediary to amend the reinsurance agreements to comply with the above laws and regulations.

## ACCOUNTS AND RECORDS

### Information Systems Controls

During the course of the examination, a review was made of the Company's general controls over its information systems. As a result of this review, several low risk findings were noted in controls over logical security, change management, and disaster recovery/business continuity planning. These findings were presented to the Company along with recommendations to strengthen its controls. The Company should evaluate the recommendations and make appropriate changes to strengthen its information systems controls.

Claims and Reserving Practices

A Claims Specialist from the California Department of Insurance performed a review of the Company's claims and reserving practices and observed that the Fair Claims Practices regulations contained in the Company's claim manual are outdated, a violation of California Code of Regulation (CCR), Title 10, Chapter 5, Subchapter 7.5, Article 1, Section 2695.6(b)(2)(A). It is recommended that the Company update the claim manual with the current regulations and institute a review process, at least annually, to ensure the regulations in the Company's claim manual are current.

The Claims Specialist also observed that the Company's claim manual does not contain any company standards for the prompt investigations and settlement of claims as required under CCR, Title 10, Chapter 5, Subchapter 7.5, Article I, Section 2695.6(a). The Company states that it uses the Fair Claims Practices (FCP) regulations as its standards for investigating and settling claims. Since the FCP regulations are the minimum standards permitted by law, the Company should establish formal written standards of its own that exceed the FCP regulations. In doing so, the claim department will provide better customer service, and in those instances where the Company's standards are not met, it will still be possible to meet the legal standards.

Conflict of Interest Statements

Conflict of interest statements were requested and reviewed for officers and directors during the exam period. It was observed that the Company did not have signed conflict of interest statements on file for some officers and directors during the examination period. It is recommended that the Company develop procedures to ensure that annual conflict of interest statements are completed timely by each officer and director and maintained by the Legal department in accordance with its conflict of interest policy.

## FINANCIAL STATEMENTS

The financial statements prepared for this examination report include:

Statement of Financial Condition as of December 31, 2009

Underwriting and Investment Exhibit for the Year Ended December 31, 2009

Reconciliation of Surplus as Regards Policyholders from December 31, 2005 through December 31, 2009

Statement of Financial Condition
as of December 31, 2009

| Assets | Ledger and Nonledger Assets | Assets Not Admitted | Net Admitted Assets | Notes |
|---|---|---|---|---|
| Bonds | $ 134,656,617 | $ | $ 134,656,617 | |
| Common stocks | 73,442,443 | | 73,442,443 | |
| Cash and short-term investments | 14,403,326 | | 14,403,326 | |
| Other invested assets | (111,143) | | (111,143) | |
| Aggregate write-ins for invested assets | 49,533 | | 49,533 | |
| Investment income due and accrued | 1,523,890 | | 1,523,890 | |
| Premiums and agents' balances in course of collection | 6,228,530 | | 6,228,530 | |
| Amount recoverable from reinsurers | 159,786 | | 159,786 | |
| Current federal and foreign income tax recoverable and interest thereon | 696,720 | | 696,720 | |
| Net deferred tax asset | 1,691,900 | | 1,691,900 | |
| Electronic data processing equipment and software | 41,974 | 41,974 | 0 | |
| Furniture and equipment, including health care delivery assets | 64,204 | 64,204 | 0 | |
| Aggregate write-ins for other than invested assets | 702,758 | 702,758 | 0 | |
| Total assets | $ 233,550,538 | $ 808,936 | $ 232,741,602 | |

| Liabilities, Surplus and Other Funds | | | |
|---|---|---|---|
| Losses | | $ 26,032,798 | (1) |
| Loss adjustment expenses | | 25,144,493 | (1) |
| Other expenses | | 684,809 | |
| Taxes, licenses and fees | | 9,132 | |
| Unearned premiums | | 17,568,837 | |
| Advance premiums | | 2,580,791 | |
| Dividends declared and unpaid: Stockholders | | 1,990,177 | |
| Dividends declared and unpaid: Policyholders | | 2,315,978 | |
| Ceded reinsurance premiums payable | | 1,871,167 | |
| Payable to parent, subsidiaries and affiliates | | 776,903 | |
| Unearned premiums - death, disability and retirement | | 15,100,000 | (1) |
| Aggregate write-ins for liabilities | | 49,533 | |
| Total liabilities | | 94,124,618 | |
| Common capital stock | $ 5,000,000 | | |
| Gross paid-in and contributed surplus | 1,000,000 | | |
| Unassigned funds (surplus) | 132,616,984 | | |
| Surplus as regards policyholders | | 138,616,984 | |
| Total liabilities, surplus and other funds | | $ 232,741,602 | |

## Underwriting and Investment Exhibit
## for the Year Ended December 31, 2009

### Statement of Income

| | | |
|---|---|---|
| **Underwriting Income** | | |
| Premiums earned | | $ 38,830,130 |
| Deductions: | | |
| Losses incurred | $ 12,667,287 | |
| Loss expenses incurred | 15,591,801 | |
| Other underwriting expenses incurred | 11,510,348 | |
| Aggregate write-in for underwriting deductions | 1,200,000 | |
| Total underwriting deductions | | 40,969,436 |
| Net underwriting loss | | (2,139,306) |
| **Investment Income** | | |
| Net investment income earned | $ 6,882,169 | |
| Net realized capital gain | 18,392 | |
| Net investment gain | | 6,900,561 |
| **Other Income** | | |
| Aggregate write-ins for miscellaneous income | $ 8,453 | |
| Total other income | | 8,453 |
| Net income before dividends to policyholders and before federal and foreign income taxes | | 4,769,708 |
| Dividends to policyholders | | 2,629,531 |
| Net income after dividends to policyholders and before federal and foreign income taxes | | 2,140,177 |
| Federal and foreign income taxes incurred | | 864,879 |
| Net income | | $ 1,275,298 |

### Capital and Surplus Account

| | | |
|---|---|---|
| Surplus as regards policyholders, December 31, 2008 | | $ 128,072,809 |
| Net income | $ 1,275,298 | |
| Change in net unrealized capital gains | 10,525,622 | |
| Change in net deferred income tax | 947,350 | |
| Change in nonadmitted assets | (492,775) | |
| Change in provision for reinsurance | 278,857 | |
| Dividends to stockholders | (1,990,177) | |
| Change in surplus as regards policyholders for the year | | 10,544,175 |
| Surplus as regards policyholders, December 31, 2009 | | $ 138,616,984 |

Reconciliation of Surplus as Regards Policyholders
from December 31, 2005 through December 31, 2009

| | | | |
|---|---|---|---|
| Surplus as regards policyholders, December 31, 2005, per Examination | | | $ 126,408,735 |
| | Gain in Surplus | Loss in Surplus | |
| Net income | $ 20,708,090 | $ | |
| Net unrealized capital losses | | 6,889,117 | |
| Change in net deferred income tax | 75,211 | | |
| Change in nonadmitted assets | 4,369,554 | | |
| Change in provision for reinsurance | 881,000 | | |
| Dividends to stockholders | | 7,351,421 | |
| Aggregate write-ins for gains and losses in surplus | 414,932 | | |
| Total gains and losses | $ 26,448,787 | $ 14,240,538 | |
| Net increase in surplus as regards policyholders | | | 12,208,249 |
| Surplus as regards policyholders, December 31, 2009, per Examination | | | $ 138,616,984 |

## COMMENTS ON FINANCIAL STATEMENT ITEMS

(1) Losses, Loss Adjustment Expenses and Unearned Premiums - Death, Disability and Retirement

A Casualty Actuary from the California Department of Insurance reviewed the Statement of Actuarial Opinion, Analysis of Unpaid Loss and LAE, and Reserve for Future Utilization of Death, Disability, and Retirement Benefit prepared by the Company's independent actuary and concurred with the conclusion that the reserves as of December 31, 2009 are reasonable.

## SUMMARY OF COMMENTS AND RECOMMENDATIONS

Current Report of Examination

Reinsurance – Ceded (Page 10): It is recommended that the reinsurance agreements with The Hartford Steam Boiler Inspection and Insurance Company (HSB) be amended to comply with California Insurance Code Section 922.2(a) and California Code of Regulations (CCR), Title 10, Chapter 5, Subchapter 3, Article 3, Section 2303.13(d). It is also recommended that all references to non-California laws be removed from the reinsurance agreements.

It is recommended that the Data Compromise and Identity Recovery quota share reinsurance agreements with HSB be amended to comply with CCR, Title 10, Chapter 5, Subchapter 3, Article 3, Section 2303.14(b), paragraphs (A) thru (C).

Accounts and Records – Information Systems Controls (Page 12): The Company should evaluate the recommendations that were presented to it and make appropriate changes to strengthen its information systems controls.

Accounts and Records – Claims and Reserving Practices (Page 13): It is recommended that the Company update the claim manual with the current regulations and institute a review process, at least annually, to ensure the regulations in the Company's claim manual are current.

Accounts and Records – Conflict of Interest Statements (Page 13): It is recommended that the Company develop procedures to ensure that annual conflict of interest statements are completed timely by each officer and director and maintained by the Legal department in accordance with its conflict of interest policy.

Previous Report of Examination

Accounts and Records (Page 10): It was recommended that the Company take measures to strengthen its information system controls. Some of the recommendations were implemented.

Comments on Financial Statement Items – Cash and Short-term Investments (Page 15): It was recommended that the Company establish formal procedures to ensure that all unclaimed checks and cash items are escheated to the State in accordance with the Unclaimed Property Law. The Company is now in compliance.

Comments on Financial Statement Items – Losses and Loss Adjustment Expenses (Page 16): It was recommended that the Company comply with SSAP 55, paragraph 4. The Company is now in compliance.

## ACKNOWLEDGMENT

Acknowledgment is made of the cooperation and assistance extended by the Company's officers and employees during the course of this examination.

Respectfully submitted,

__________/S/__________________

Ber Vang, CFE, AES, CISA
Examiner-In-Charge
Department of Insurance
State of California